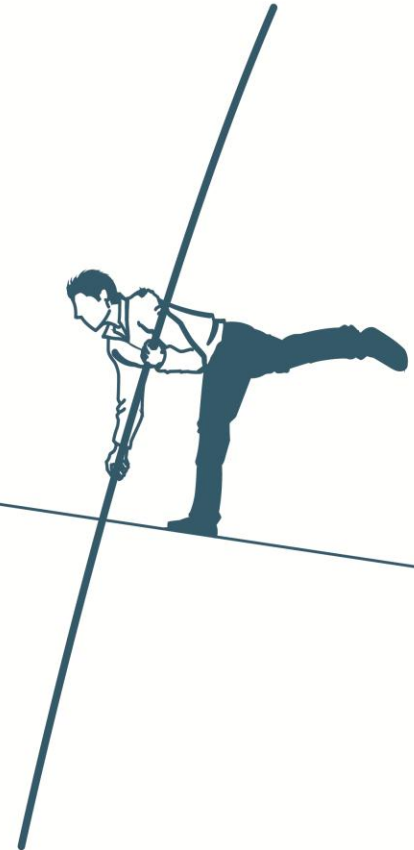


ACHIEVING THE RIGHT BALANCE

CalPERS Board Governance Study
Revised Interim Report and
First Reading for Approvals

August 4, 2011 Draft



1. SUMMARY OF CONSIDERATIONS

The following considerations are proposed as alternatives to the status quo. The board will need to determine whether or not to accept these alternatives on a case-by-case basis. Every attempt has been made to harmonize feedback from board members from initial interviews, from the full board discussion at the July 2011 meeting and from board feedback following the July meeting.

Board Member Feedback from the July Meeting

- In general, the seven board members who provided specific feedback expressed broad support for pursuing the considerations posed for discussion at the July board meeting, in the following areas:
 - Adoption of the proposed Principles for Effective Governance.
 - Clarifying and aligning the powers reserved for the board.
 - Sharpening the focus of the committees and their charters.
 - Improving the balance between strategy and operations, setting priorities, and strengthening the focus on the strategic agenda.
 - Improving the working relationship with the CEO and executive staff and developing a succession plan.
 - Working with the executive staff to develop the strategic agenda and a board self-development plan with topics tied to the agenda.
 - Streamlining reporting, implementing structured executive summaries, utilizing exception reporting, and ensuring the new board portal dramatically improves access to structured information.
 - Improving meeting efficiency, rules of order, and protocols.
 - Implementing an effective self-assessment process which utilizes several different bases of evaluation (e.g., principles, responsibility and authority, process, and outcomes).
 - Adopting a confidentiality policy (subject to legal analysis).

Board Member Feedback from the July Meeting

- Specific considerations which appear to require more discussion include:
 - Single (CEO) versus dual (CEO and CIO) reports to the board – status quo is not supported.
 - Simplification of the proposed list of powers reserved for the board.
 - Revised committee structure:
 - Want to consider consolidating finance, administration, risk and audits into a single committee instead of having two separate Finance & Administration and Risk & Audit Committees.
 - Want to further evaluate rationale for consolidation of BPAC and Health Committees.
 - How to best achieve independent reassurance:
 - Sentiment seems to be for the CRO to report to the CFO.
 - Need to develop a revised independent reassurance model which provides for:
 - Independent oversight of financial processes.
 - Board reporting from the CRO, chief auditor, chief actuary, and key investment staff.
 - How to implement and “phase in” exception reporting and thresholds.
 - How to ensure the executive compensation system is linked to strategy and performance.
 - Frequency of educational sessions as part of regular board meetings.
 - Potential public reporting of board member self-development activities.
 - Use of independent third parties to:
 - Facilitate the self-assessment process.
 - Perform a bi-annual independent board performance assessment.

Board Member Feedback from the July Meeting

- Specific considerations which appear not to be supported include:
 - Advocacy to the governor or legislature on desired board member skill profiles for future appointments.

Summary of Considerations

- A. Principles for Effective Governance of Public Pension Funds
- B. Role of the Board and Committees
- C. Role of President and Vice President / Chairs and Vice-Chairs
- D. Powers Reserved
- E. Committee Structure
- F. Delegations to Executives and Board Reporting Relationships
- G. Setting the Board Agenda and Improving Reporting to the Board
- H. Board Self-Assessment Process
- I. Board Self-Development Process
- J. Selected Policies Governing Board Conduct

Summary of Considerations

A. Principles for Effective Public Pension Fund Governance

Recommendation:

- Adopt the proposed Principles for Effective Public Pension Fund Governance.

Summary of Considerations

B. Role of the Board and Committees

Recommendation: Adopt the following policies:

- Each board member signs an annual statement acknowledging fiduciary responsibilities.
- An annual “state of the union” report by the President.
- Use an independent third party to assess board performance once every two years.
- Develop a long-term CEO succession plan.

Summary of Considerations

C. Role of the President / Vice President / Chairs / Vice Chairs

Recommendation:

- Confirm the role of the President as defined in the existing CalPERS Statement of Governance Principles.
- Evaluate the current role of Board Staff Unit re: travel to promote improved compliance and control.
- Confirm the role of the Vice President as defined in the existing CalPERS Statement of Governance Principles.
- Confirm the role of the Committee Chairs and Vice Chairs as defined in the existing CalPERS Statement of Governance Principles.
- Evaluate the best means to improve the board briefing process.
- Obtain leadership education for Committee Chairs and Vice Chairs.
- Develop a framework to hold all executives accountable for performance linked to the, agreed organization strategy, performance metrics and compensation system.

Summary of Considerations

D. Powers Reserved for the Board

Next Steps:

- Further discuss and clarify definitions of powers reserved for the board.

Summary of Considerations

E. Board Committee Structure

Recommendations:

- Ensure the process for nominating and electing committee chairs and vice chairs is transparent and well understood.
- Adopt a policy to review and update committee charters annually.
- Realign administrative activities into the Finance Committee (primarily from BPAC).

Next Steps:

- Further discuss the pros and cons of other committee structure options. E.g.,
 1. Consolidate all reinsurance activities into Risk and Audit.
 2. Combine Health and most elements of BPAC into Benefit Programs and Policy.
 3. Combine Finance and Administration and Risk and Audit into one new committee.

Summary of Considerations

F. Delegations to Executives and Board Reporting Relationships

Recommendation: Adopt the following policies:

- The board will evaluate direct report performance and compensation based on the agreed-upon strategy, performance outcomes and metrics, not just activities.
- If the board is not satisfied with the performance of its direct report(s), it will discipline or replace the executive(s) but should not get involved in day-to-day operations.
- The direct report(s) are responsible for providing reasonable assurance to the board that there are capable people, processes and systems in place to achieve agreed-upon outcomes while managing related risks so that they are within CalPERS established risk appetite.
- The board will have ready access to all executives, such access to be coordinated by the CEO.
- The board direct report(s) have the primary authority and responsibility for the hiring, evaluation, compensation and termination of their direct reports.
- The Chief Investment Officer retains investment autonomy and decision authority over hiring, evaluation, compensation and firing of Investment Office personnel.
- Executives (to the level of senior portfolio managers) are required to certify in writing at least annually that they have been free from undue influence by the board, executives or third parties.
- The board should establish a schedule of closed session meetings with selected executives i.e., making frequent reports to the board or significant investment decisions

Summary of Considerations

F. Delegations to Executives and Board Reporting Relationships (cont'd)

Next Steps:

- Further discuss pros and cons of single direct (CEO) versus dual (CEO and CIO) reporting structure to the board.
- Further discuss the pros and cons of various approaches for obtaining independent reassurance for the board.

Summary of Considerations

G. Setting the Board Agenda and Improving Reporting to the Board

Setting the Board Agenda

Recommendation: Adopt the following policies:

- The setting of the board agenda is tied directly to the annual planning calendar.
- The board agenda is tied directly to the board's approval and oversight responsibilities and related outcomes.
- The President and CEO, in consultation with the Committee Chairs, actively engage the board in setting the strategic agenda and review and adjust quarterly.
- The CEO engages the board in collaboratively developing the strategy.
- The board adopts a uniform framework requiring preparation of executive summaries to provide greater insight, replacing the existing board agenda setting process.

Summary of Considerations

G. Setting the Board Agenda and Improving Reporting to the Board (cont'd)

Reports and meeting protocols

Recommendation: Adopt the following policies:

- The board and each committee will review all current information reports to determine those which are statutorily required and those which may be streamlined or removed.
- The board will define its information requirements, the thresholds that trigger board attention for each topic, and the frequency of standard reports.
- The CEO is responsible for keeping the board appropriately informed and escalating issues on a timely basis.
- The board will make use of consent agendas.
- The President and CEO are responsible for providing the board with executive summaries of data.
- The CEO will assign a specific senior executive to coordinate with each committee and collaboratively develop the annual agenda proposals, and the effective and efficient flow of pertinent information is a compensable performance goal for the responsible executive.
- Each committee maintains a standing set of questions pertinent to recurring decisions or oversight.

Summary of Considerations

G. Setting the Board Agenda and Improving Reporting to the Board

Reports and meeting protocols (continued)

Recommendation (continued): Adopt the following policies:

- The board confirms its current policy regarding ad hoc requests for additional documents and reports, taking into account the effect on staff time and resources required to produce such reports.
- A sunset review of new reports will be conducted at appropriate intervals to determine their continuing utility.
- A board portal will be implemented to facilitate effective decision making and use of board member time.

Summary of Considerations

H. Board Self-Assessment Process

Recommendation:

- Develop and implement a new self-assessment process which assesses the whole board, the president and vice president, individual members, committees, and committee chairs and vice chairs, and includes multiple bases for evaluation:
 - Principles.
 - Responsibility and Authority.
 - Process.
 - Outcomes.
- Utilize one or more techniques for obtaining self-assessment feedback:
 - Expert third party facilitator to lead or co-lead (with the Board President) the self-assessment process.
 - Get feedback from external key stakeholders on board performance.
 - Obtain an independent third party evaluation of the board's performance.
- Include peer-to-peer (360°) and upward evaluations from staff.

Summary of Considerations

I. Board Self-Development Process

Recommendation:

- Establish an annual continuing education plan and budget.
- Obtain education on the role of the board vis-à-vis management and the role of the chairs and vice-chairs in the effective management of board and staff time.
- Develop a profile of the skills and attributes desired for the board overall and for each committee chair and member, and arrange for board development programs consistent with the desired attributes and skills.
- Tie the decision-making agenda directly to board self-development.
- Build an educational element into each board meeting, or if not each meeting, in a regular cadence.

Next Steps:

- Further discuss public reporting of the annual development activities completed by each member.

Summary of Considerations

J. Selected Policies Governing Board Conduct

Recommendation:

- For matters which legitimately should be kept confidential (personnel matters, contract negotiations, sensitive investment information), adopt a confidentiality policy which:
 - Provides for disciplinary action if violated.
 - Applies to board members, staff, and external service providers.
 - Prohibits use of confidential information for personal gain or for the benefit of outside interests.

2. NEXT STEPS

Next Steps

- Obtain additional feedback from the board following the presentation.
 - Agreements to proceed to second reading.
 - Requirements for additional modifications or analysis.
- Obtain direction on items under discussion.
- Develop work plan for final presentation at September board meeting.